



## **Report of the auditor-general to the North West provincial legislature and the council on the Rustenburg Local Municipality**

### **Report on the consolidated and separate financial statements**

#### **Introduction**

1. I have audited the consolidated and separate financial statements of the Rustenburg Local Municipality and its municipal entity set out on pages XX to XX, which comprise the consolidated and separate statement of financial position as at 30 June 2016, the consolidated and separate statement of financial performance, the statement of changes in net assets, the cash flow statement and the statement of comparison of budget with actual amounts for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

#### **Accounting officer's responsibility for the consolidated and separate financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these consolidated and separate financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice (SA standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2015 (Act No. 1 of 2015) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of consolidated and separate financial statements that are free from material misstatement, whether due to fraud or error.

#### **Auditor-general's responsibility**

3. My responsibility is to express an opinion on these consolidated and separate financial statements based on my audit. I conducted my audit in accordance with International Standards on Auditing. Those standards require that I comply with ethical requirements, and plan and perform the audit to obtain reasonable assurance about whether the consolidated and separate financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated and separate financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the consolidated and separate financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated and separate financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the

reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated and separate financial statements.

5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

## **Basis for qualified opinion**

### **Property, plant and equipment**

6. The municipality did not review the residual values and useful lives of property, plant and equipment at each reporting date in accordance with GRAP 17 *Property, plant and equipment*. I was not able to determine the impact on the net carrying amount of property, plant and equipment of R8 108 009 000 and R7 703 959 000 respectively disclosed in note 4 to the consolidated and separate financial statements, the related depreciation and amortisation expenses of R378 247 000 and R361 692 000 respectively disclosed in note 34 to the consolidated and separate financial statements, or the resultant impact on the surplus for the year and the accumulated surplus, as it was impracticable to do so.

### **Service charges**

7. The municipality did not account for all revenue from service charges in the current period in accordance with GRAP 9 *Revenue from exchange transactions* as not all consumers were billed for services for the year under review. I was unable to determine the full extent of this understatement on service charges, the resultant impact on the surplus for the year and the accumulated surplus, as it was impracticable to do so. In addition, I was unable to obtain sufficient appropriate audit evidence for estimated billings of water and electricity consumption on consumer accounts. The municipality's records did not permit the application of alternative audit procedures. Consequently, I was unable to determine whether any further adjustments to service charges of R2 245 016 000 and R2 193 661 000 disclosed in note 25 and the related receivables from exchange transactions of R387 086 000 and R375 581 000 respectively disclosed in note 13 to the consolidated and separate financial statements, were necessary.

### **Interest received from trading activities**

8. I was unable to obtain sufficient appropriate audit evidence for interest received from trading activities, as the municipality did not have adequate systems to maintain records of the consumer debtor balances on which interest was charged. I was unable to confirm the interest received from trading activities by alternative means. Consequently, I was unable to determine whether any adjustments relating to interest received from trading activities of R143 784 000 and the related consumer debtors of R394 692 000 and R383 352 000 respectively disclosed in note 16 to the consolidated and separate financial statements, were necessary.

### **Commitments**

9. I was unable to obtain sufficient appropriate audit evidence for commitments as the municipality did not have an adequate contract management system to record, maintain and reconcile payments made on its commitments. Additionally, the commitments was understated by R84 734 450 due to the commitments register not being mathematically accurate. I was unable to confirm these commitments by alternative means. Consequently, I was unable to determine whether any further adjustments relating to commitments of R1 173 216 000 (2015: R649 628 000) and R1 059 196 000 (2015: R559 884 000) respectively disclosed in note 44 to the consolidated and separate financial statements, were necessary.

## **Irregular expenditure**

10. Section 125 of the MFMA requires the disclosure of irregular expenditure incurred. The municipality made payments of R6 564 092 (2015: R9 999 751) in contravention with the supply chain management requirements, which were not included in irregular expenditure as disclosed. Additionally, in the prior year the municipality incorrectly included VAT in the total amount of irregular expenditure disclosed, resulting in the irregular expenditure as disclosed in note 54 to the consolidated and separate financial statements being overstated by R410 889 642. However, because the municipality did not quantify the full extent of the irregular expenditure incurred it was impracticable to determine the resultant misstatement of irregular expenditure as disclosed in note 54 to the consolidated and separate financial statements.

## **Qualified opinion**

11. In my opinion, except for the effects of the matters described in the basis for qualified opinion paragraphs, the consolidated and separate financial statements present fairly, in all material respects, the financial position of the Rustenburg Local Municipality and its municipal entity as at 30 June 2016 and their financial performance and cash flows for the year then ended, in accordance with the SA standards of GRAP and the requirements of the MFMA and the DoRA.

## **Emphasis of matters**

12. I draw attention to the matters below. My opinion is not modified in respect of these matters.

## **Unauthorised, fruitless and wasteful expenditure**

13. As disclosed in note 52 to the consolidated and separate financial statements, unauthorised expenditure of R427 557 000 was incurred in the current year and the unauthorised expenditure of R564 023 000 in respect of prior years had not yet been dealt with in accordance with section 32 of the MFMA.
14. As disclosed in note 53 to the consolidated and separate financial statements, fruitless and wasteful expenditure of R894 000 was incurred in the current year and fruitless and wasteful expenditure of R537 000 from prior years had not yet been dealt with in accordance with section 32 of the MFMA.

## **Material losses**

15. As disclosed in note 55 to the consolidated and separate financial statements, material losses of R135 547 000 (2015: R121 389 000) were incurred as a result of water lost through the distribution process.
16. As disclosed in note 35 to the consolidated and separate financial statements, material losses of R423 667 000 (2015: R394 375 000) were incurred as a result of an increase in the provision for impairment on receivables from exchange transactions.

## **Restatement of corresponding figures**

17. As disclosed in note 47 to the consolidated and separate financial statements, the corresponding figures for 30 June 2015 have been restated as a result of errors discovered during 2016 in the financial statements of the Rustenburg Local Municipality at, and for the year ended, 30 June 2015.

## **Material underspending of the conditional grant**

18. As disclosed in note 20 to the consolidated and separate financial statements, the municipality has unspent conditional grants of R263 337 000 (2015: R434 448 000) as a result of conditional grant funding not fully utilised during the financial year.

## **Additional matters**

19. I draw attention to the matter below. My opinion is not modified in respect of this matter.

## **Unaudited disclosure notes**

20. In terms of section 125(2)(e) of the MFMA the municipality is required to disclose particulars of non-compliance with the MFMA. This disclosure requirement did not form part of the audit of the financial statements and accordingly I do not express an opinion thereon.

## **Report on other legal and regulatory requirements**

21. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives for selected development priorities presented in the annual performance report, compliance with legislation and internal control. The objective of my tests was to identify reportable findings as described under each subheading but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

## **Predetermined objectives**

22. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected development priorities presented in the annual performance report of the municipality for the year ended 30 June 2016:
- Development priority 1: Efficient provision of quality basic services and infrastructure within a well-planned spatial structure on pages x to x
  - Development priority 2: Drive diversified economic growth and job creation on pages x to x
23. I evaluated the usefulness of the reported performance information to determine whether the reported performance was consistent with the planned development priorities. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's Framework for managing programme performance information (FMPPi).
24. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
25. The material findings in respect of the selected development priorities are as follows:

## **Development priority 1: Efficient provision of quality basic services and infrastructure within a well-planned spatial structure**

## **Usefulness of reported performance information**

26. Section 41(c) of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA) requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 69% of reported targets were not consistent with those in the approved integrated

development plan.

27. The FMPPPI requires that indicators be well defined and verifiable and targets be specific, measureable and time bound:
- A total of 75% of targets were not specific and measurable.
  - A total of 20% of indicators were not verifiable.

### **Reliability of reported performance information**

28. The FMPPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure reliable reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the reported performance information. This was due to limitations placed on the scope of my work due to the absence of information systems and the fact that the auditee could not provide sufficient appropriate evidence in support of the reported performance information. The auditee's records did not permit the application of alternative audit procedures

## **Development priority 2: Drive diversified economic growth and job creation**

### **Usefulness of reported performance information**

29. Section 41(c) of the MSA requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 50% of reported indicators and 75% of reported targets were not consistent with those in the approved integrated development plan.
30. The FMPPPI requires that indicators be well defined and verifiable and targets be specific, measureable and time bound:
- A total of 67% of targets were not measurable.
  - A total of 33% of the indicators were not well defined or verifiable.

### **Reliability of reported performance information**

31. The FMPPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure reliable reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the reported performance information. This was due to limitations placed on the scope of my work due to the absence of information systems and the fact that the auditee could not provide sufficient appropriate evidence in support of the reported performance information. The auditee's records did not permit the application of alternative audit procedures.

### **Additional matter**

32. I draw attention to the following matter:

### **Achievement of planned targets**

33. Refer to the annual performance report on pages XX to XX for information on the achievement of the planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information for the selected development priorities reported in paragraphs XX to XX of this report.

## **Compliance with legislation**

34. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My findings on material compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

## **Strategic planning and performance management**

35. The performance management system did not provide for policies and procedures to take steps of improvement where performance targets were not met, as required by section 41(1)(d) of the MSA.
36. Annual performance objectives and indicators were not established by agreement with the Rustenburg Water Services Trust and included in the municipal entity's multi-year business plan, as required by section 93B(a) of the MSA.
37. Revisions to the service delivery and budget implementation plan (SDBIP) were not approved by the council as required by section 54(1)(c) of the MFMA.

## **Annual financial statements, performance and annual reports**

38. The financial statements submitted for auditing were not in all material respects prepared in accordance with the requirements of section 122 of the MFMA.
39. Material misstatements of non-current assets, current assets, expenditure and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.
40. The oversight report adopted by the council on the 2014-15 annual report was not made public within seven days, as required by section 129(3) of the MFMA.
41. The annual performance report for the year under review did not include an evaluation of each external services provider as required by section 46(1)(a) of the MSA.

## **Procurement and contract management**

42. I could not obtain sufficient appropriate audit evidence that contracts were awarded to bidders based on points given for criteria that were stipulated in the original invitation for bidding, as required by SCM regulations 21(b) and 28(1)(a) and the Preferential Procurement Regulations.
43. The performance of contractors or providers were not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA .
44. Persons in service of the municipality whose close family members had a private or business interest in contracts awarded by the municipality, failed to disclose such interest, in contravention of SCM regulation 46(2)(e).

## **Human resource and compensation management**

45. The competencies of financial and supply chain management officials were not assessed in a timely manner in order to identify and address gaps in competency levels as required by regulation 13 of the Municipal Regulations on Minimum Competency Levels.
46. The municipality did not develop and adopt appropriate systems (policies) and procedures to monitor, measure and evaluate performance of staff in contravention of section 67(d) of the MSA.

## **Expenditure management**

47. Reasonable steps were not taken to prevent unauthorised, irregular and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

## **Asset management**

48. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA.
49. All investments were not made in accordance with the requirements of the investment policy of Council.
50. The municipality made investments in listed shares which are in contravention of regulation 6 of the Municipal Investment Regulations.

## **Conditional grants received**

51. The Public Transport Network Grant (PTNG) allocation was not spent in accordance with the applicable grant framework, in contravention of section 17(1) of the DoRA. Of the total unspent conditional grants at year end that were not backed by sufficient cash in the bank, 82% relates to the PTNG.

## **Revenue management**

52. I was unable obtain sufficient audit evidence that interest had been charged on all accounts in arrears, as required by section 64(2)(g) of the MFMA.

## **Consequence management**

53. Unauthorised, irregular, fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by sections 32(2)(a) and (b) of the MFMA.
54. Council did not always approve the terms of reference of each investigation as required by regulation 6(1) of the Municipal regulations on financial misconduct procedures and criminal proceedings.
55. Allegations of financial misconduct laid against officials of the municipality were not investigated as required by section 171(4)(a) of the MFMA.

## **Environmental management**

56. The municipality did not exercise its legislative and executive authority of managing, monitoring and enforcing environmental related bylaws to promote a safe and healthy environment as required by sections 11(3)(l) and (m) of the MSA.
57. The municipality operated its wastewater treatment facilities without a license in contravention of the section 24(2)(a) of the National Environmental Management Act, 1998 (Act No. 107 of 1998) (NEMA) and section 22(1)(b) of the National Water Act, 1998 (Act No. 36 of 1998) (NWA).
58. The municipality's operational activities at its waste disposals sites contravened or failed to comply with the requirements of the waste management license or the norms and standards as prescribed by sections 67(1)(f) and (h) of the National Environmental Management Waste Act, 2008 (Act No. 59 of 2008) (NEMWA).
59. The municipality's waste management and disposal activities contravened or failed to comply with the requirements of section 28(1) of the NEMA, section 19 of the NWA and



sections 16(1)(c) and (d) and 26(1)(b) of the NEMWA.

## **Internal control**

60. I considered internal control relevant to my audit of the financial statements, the annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for qualified opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.

## **Leadership**

61. The corrective action plans initiated by leadership to address prior year audit findings were not effectively implemented by management. The implementation thereof was mostly done through consultants without addressing the underlying deficiencies in the systems or in the day to day internal control environments. There was a lack of continuity in key management positions due to suspensions and resignations. The slow response by leadership, management and oversight to audit findings identified in prior periods has led to a regression in key financial reportable areas.

## **Financial and performance management**

62. Management did not implement effective controls to ensure that all information in the financial statements and the report on predetermined objectives were reliable before submission for audit. These shortcomings are evident at year-end during the annual reporting but are also seen during the course of the financial year with management relying heavily on consultants to assist in the financial reporting processes. This negatively impacts the reporting and budget monitoring processes and the quality of the financial information provided to council during the course of the year. There remains a continuous non-adherence to the council's supply chain management policy without consequences, reflecting negatively on management's commitment towards a clean administration.

## **Governance**

63. Management do not have an adequate risk strategy that addresses identified risks and shortfalls in the municipality's financial systems, in supply chain management, performance reporting as well as non-compliances with laws and regulations. The effectiveness of the audit committee and internal audit's role as an assurance provider was compromised by management's inability to adequately address and react to internal audit's findings and recommendations.

*Auditor-General*

Rustenburg

10 February 2017



AUDITOR-GENERAL  
SOUTH AFRICA

*Auditing to build public confidence*

